

Message Text

LIMITED OFFICIAL USE

PAGE 01 LONDON 05020 01 OF 02 251839Z
ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04
CEA-01 DODE-00 PA-01 PRS-01 IO-13 L-03 H-01
ITC-01 AGRE-00 FEAE-00 OES-06 ERDA-05 /118 W
-----251954Z 107545 /45

R 251804Z MAR 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 1987
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION EC BRUSSELS
USMISSION OECD PARIS
AMCONSUL EDINBURGH

LIMITED OFFICIAL USE SECTION 01 OF 02 LONDON 05020

E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: BACKGROUND ON THE BUDGET

REF: LONDON 4791 (NOTAL)

SUMMARY: WITH THE GOVERNMENT'S SURVIVAL TEMPORARILY ASSURED, ATTENTION RETURNS TO THE MARCH 29 BUDGET. THIS YEAR THE CHANCELLOR'S ROOM FOR MANEUVER IS MORE CIRCUMSCRIBED THAN USUAL. UNDER THE TERMS OF THE IMF LETTER OF INTENT, THE PUBLIC SECTOR BORROWING REQUIREMENT TARGET HAS BEEN STATED PRIOR TO THE BUDGET. PUBLIC SPENDING PLANS WERE REVEALED IN THE JANUARY WHITE PAPER. A FURTHER COMPLICATION IS THE PERCEIVED POLITICAL IMPERATIVE
LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 LONDON 05020 01 OF 02 251839Z

OF ACHIEVING A FURTHER YEAR OF WAGE RESTRAINT. WHILE ALL INDICATIONS ARE THAT THE FY 77/78 BUDGET WILL HAVE STRONG POLITICAL OVERTONES WITH TAX REDUCTIONS BEING USED AS A CARROT TO INDUCE ORGANIZED LABOR TO SUPPORT CONTINUING WAGE RESTRAINT, THE OVERALL SIZE OF THOSE REDUCTIONS IS NOT LIKELY TO JEOPARDIZE THE TERMS OF THE IMF LETTER OF INTENT. END SUMMARY.

1. THE GENERAL OUTLINES OF THE MARCH 29 BUDGET HAVE BEEN THE SUBJECT OF WIDESPREAD DISCUSSION IN THE ECONOMIC MEDIA, AMONG ACADEMICS. IN FINANCIAL AND BUSINESS CIRCLES AND AMONG TRADE UNIONS. IN ADDITION, THE EMBASSY HAS HAD SOME ADVANCE INDICATIONS FROM OFFICIAL SOURCES (REFTEL). MOST OBSERVERS AGREE THAT SOME SCOPE EXISTS FOR A TAX REDUCTION. WHILE OPINIONS DIFFER OVER THE EXACT SHAPE OF SUCH A REDUCTION, THERE IS GENERAL AGREEMENT THAT THE BURDEN OF TAXATION SHOULD BE SHIFTED AWAY FROM TAXES ON INCOME AND TOWARD TAXES ON EXPENDITURE.

2. IN PREPARING HIS BUDGET PROPOSALS, THE CHANCELLOR BEGAN WITH A SET OF ECONOMIC AND POLITICAL IMPERATIVES. THE FORMER ARE CONTAINED IN THE IMF LETTER OF INTENT AND THE JANUARY PUBLIC EXPENDITURE WHITE PAPER. THE IMF LETTER ESTABLISHED A PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) OF 8.7 BILLION POUNDS AND A DOMESTIC CREDIT EXPANSION CEILING OF 7.7 BILLION POUNDS FOR THE FISCAL YEAR BEGINNING APRIL 1. THE PUBLIC EXPENDITURE WHITE PAPER PLACED PLANNED OUTLAYS FOR THE SAME PERIOD AT 52.5 BILLION POUNDS IN 1976 SURVEY PRICES. THESE ELEMENTS HAVE BEEN PUT INTO HM TREASURY'S ECONOMETRIC MODEL WHICH HAS GENERATED A FORECAST FOR THE COMING 12 MONTHS INCLUDING ESTIMATES OF OUTPUT, EMPLOYMENT PRICES AND THE PSBR.

3. THE PSBR GENERATED BY THE MODEL IS BELIEVED TO BE IN THE RANGE OF 8.0 BILLION POUNDS COMPARED WITH THE 8.7 BILLION POUND IMF TARGET. ARMED WITH THE MODEL'S PROJECTED LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 LONDON 05020 01 OF 02 251839Z

TIONS, WE SURMISE THAT THE CHANCELLOR HAS CONCLUDED THAT, IN THE ABSENCE OF A TAX CUT, OVERALL FISCAL POLICY WILL BE TIGHTER THAN INTENDED, PERHAPS REDUCING AGGREGATE DEMAND BY 0.3 TO 0.5 PERCENT FROM WHAT IT OTHERWISE WOULD HAVE BEEN. SUCH MINOR CHANGES BECOME IMPORTANT DURING A PERIOD OF SLOW GROWTH.

4. THUS, THE CHANCELLOR IS FACED WITH DESIGNING A PACKAGE OF TAX CUTS WHICH WILL PRODUCE THE TARGET PSBR AGREED WITH THE IMF. IN THE ABSENCE OF OTHER CONSTRAINTS IT IS GENERALLY ACCEPTED THAT AN INCOME TAX CUT AT BOTH EXTREMES OF THE INCOME SCALE WOULD HAVE THE MOST BENEFICIAL ECONOMIC IMPACT, SINCE IT WOULD ENCOURAGE THOSE RECEIVING LOW INCOMES TO SEEK EMPLOYMENT RATHER THAN REMAINING ON WELFARE WHILE ENCOURAGING ENTREPRENEURSHIP AND CREATIVITY AMONG THOSE WITH HIGH INCOMES.

5. THEORETICALLY, TWO ALTERNATIVES APPEAR TO BE LIKELY IF OPTIMAL TAX CUTS FOR THESE GROUPS ARE TO BE ACHIEVED.

SINCE SUCH CUTS WOULD PRODUCE LESS OVERALL REVENUE THAN IS NEEDED TO ACHIEVE THE TARGET PSBR OF 8.7 BILLION POUNDS, THE CHANCELLOR WOULD EITHER HAVE TO RAISE TAXES ON AVERAGE INCOME EARNERS OR BARRING THAT, RAISE EXPENDITURE TAXATION. BOTH COURSES RISK ALIENATING LABOR GOV-

LIMITED OFFICIAL USE

NNN

LIMITED OFFICIAL USE

PAGE 01 LONDON 05020 02 OF 02 251839Z
ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04
CEA-01 DODE-00 PA-01 PRS-01 IO-13 L-03 H-01
ITC-01 AGRE-00 FEAE-00 OES-06 ERDA-05 /118 W
-----251954Z 107556 /45

R 251804Z MAR 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 1988
TREASURY DEPT WASHDC
INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION EC BRUSSELS
USMISSION OECD PARIS
AMCONSUL EDINBURGH

LIMITED OFFICIAL USE SECTION 02 OF 02 LONDON 05020

ERNMENT SUPPORTERS. IN THE CASE OF INCREASED INCOME TAXES, TAKE-HOME PAY WOULD BE FURTHER REDUCED, WHILE IN THE CASE OF EXPENDITURE TAXATION, RETAIL PRICE INFLATION WOULD BE IMMEDIATELY BOOSTED. THESE ALTERNATIVES ARE NOT MUTUALLY EXCLUSIVE SINCE A SMALLER INCREASE IN INCOME TAXATION ON AVERAGE EARNINGS COULD BE COMBINED WITH A GREATER INCREASE IN EXPENDITURE TAXATION. THIS WOULD HAVE THE DESIRABLE EFFECT OF SHIFTING THE BURDEN FROM INCOME TO EXPENDITURE TAXATION.

6. WHILE A PACKAGE BENEFITING TAXPAYERS AT THE EXTREMES OF THE INCOME SCALE HAS BROAD THEORETICAL APPEAL, SUCH A LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 LONDON 05020 02 OF 02 251839Z

SYMMETRICAL OUTCOME IS MOST UNLIKELY. HMG IS STRONGLY COMMITTED TO BRINGING ABOUT A SHARP REDUCTION IN THE RATE OF INFLATION BUT EQUALLY STRONGLY FEARS FURTHER RISES IN UNEMPLOYMENT. ITS IMF COMMITMENTS ON PUBLIC SECTOR BORROWING AND DOMESTIC CREDIT EXPANSION MEAN THAT THE LEVEL OF WAGE SETTLEMENTS DURING THE COMING YEAR MUST BE HELD TO A MINIMUM IF UNEMPLOYMENT IS TO BE STABILIZED. INDEED, SOURCES IN HMG WOULD BE DELIGHTED WITH A THIRD-YEAR INCOMES POLICY WHICH BOTH EASED THE ANOMALIES BUILT UP DURING THE FIRST TWO YEARS AND HELD THE GROWTH IN AVERAGE EARNINGS TO 10 PERCENT. HOWEVER, THIS IS A VERY OPTIMISTIC TARGET.

7. LIMITING THE RATE OF EXPANSION OF DOMESTIC CREDIT (DCE) TO THE SPECIFICATIONS OF THE LETTER OF INTENT SHOULD LIMIT THE AMOUNT OF MONEY AVAILABLE TO EMPLOYERS TO OFFER AND STILL SUSTAIN CURRENT LEVELS OF EMPLOYMENT. IF THERE IS NO WAGE RESTRAINT POLICY, IT IS POSSIBLE THAT THE EROSION IN REAL INCOMES THAT HAS ALREADY OCCURRED WOULD ENCOURAGE UNIONS TO ATTEMPT TO SECURE IMMEDIATE WAGE SETTLEMENTS FOR THEIR MEMBERS WHATEVER THE UNEMPLOYMENT RISK. TO FORESTALL THIS, HMG NEEDS A FURTHER YEAR OF WAGE RESTRAINT.

8. THE CHANCELLOR IS THEREFORE LIKELY TO USE THE SCOPE FOR TAX REDUCTION AS AN INCENTIVE FOR ORGANIZED LABOR TO AGREE TO ANOTHER PAY DEAL. THE BULK OF THE TAX CUTS IS LIKELY TO GO TO PEOPLE EARNING INCOMES AT OR NEAR THE NATIONAL AVERAGE (70 POUNDS A WEEK) WITH MUCH LESS GOING TO THOSE AT THE UPPER EXTREME OF THE INCOME SCALE. SINCE THE AVAILABLE REVENUES TO FINANCE A TAX CUT ARE CLEARLY INSUFFICIENT TO PROVIDE MEANINGFUL RELIEF TO AVERAGE EARNERS, A RISE IN EXPENDITURE TAXATION IS A VIRTUAL CERTAINTY TO PROVIDE THE DIFFERENCE. IT IS PROBABLE THAT THE CHANCELLOR WILL ANNOUNCE AN INCREASE IN THE RATE OF VALUE ADDED TAXATION FROM ITS CURRENT LEVEL OF 8 PERCENT.

LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 LONDON 05020 02 OF 02 251839Z

DESPITE THE IMPACT ON THE RETAIL PRICE INDEX, EXCISE TAXES ON TOBACCO, ALCOHOL AND PETROLEUM PRODUCTS ARE ALSO PRIME CANDIDATES FOR INCREASES.

9. THE CHANCELLOR, VERY COGNIZANT OF THE FACT THAT THE TUC HAS VOICED ITS ANNOYANCE OVER HIS LINKAGE OF TAX CUTS WITH WAGE RESTRAINT LAST YEAR WILL BE MORE CAREFUL THIS TIME. HOWEVER, HE MAY SUGGEST IN BROAD TERMS THAT IF THE ECONOMY WERE TO PERMIT, HE WOULD BE PREPARED TO INTRODUCE FURTHER TAX REDUCTIONS LATER IN THE YEAR, THUS AVOIDING AN OVERT LINKAGE WITH WAGE RESTRAINTS WHILE KEEPING UP THE PRESSURE FOR A PAY DEAL.

10. AT THE MAXIMUM, HIS OVERALL PACKAGE IS NOT LIKELY TO OFFSET THE ENTIRE AMOUNT OF FISCAL DRAG (1.7 BILLION POUNDS ACCORDING TO THE TREASURY) THAT HAS BUILT UP AS A RESULT OF THE 16 PERCENT INCREASE IN PRICES SINCE LAST APRIL. IT SHOULD ALLOW THE ECONOMY TO GROW BY 1.5 TO 2.5 PERCENT IN REAL TERMS DURING THE FISCAL YEAR, ADDING PERHAPS 0.5 PERCENT IN REAL TERMS TO THE RATE OF REAL GROWTH DURING THE FISCAL YEAR.

SPIERS

LIMITED OFFICIAL USE

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: REPORTS, POLICIES, BUDGETS, ECONOMIC PROGRAMS
Control Number: n/a
Copy: SINGLE
Sent Date: 25-Mar-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON05020
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770103-0377
Format: TEL
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770322/aaaaasyo.tel
Line Count: 243
Litigation Code IDs:
Litigation Codes:
Litigation History: Hold (001 Tobacco) added on 4/16/2009 3:39:09 PM by WASHDCMcGoldRJ, Hold (001 Tobacco) removed on 4/16/2009 3:45:07 PM by WASHDCMcGoldRJ (Litigation Hold Lifted)
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 2f3ed0b1-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: 77 LONDON 4791
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 07-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 2998493
Secure: OPEN
Status: NATIVE
Subject: BACKGROUND ON THE BUDGET
TAGS: EFIN, UK
To: STATE TRSY
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/2f3ed0b1-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009